Understanding the Nature of Markets

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I first began investing/speculating in the late 1970s in physical silver and have gone on to try my hand at most vehicles, including stocks, stock mutual funds, stock and index options, stock and commodity ETFs, bonds, and currencies. I have bought and read several shelves full of books on finance, markets and economics. I have subscribed to advisory services of all sorts. I've bought and used more "miracle" prediction systems than I care to enumerate. I have waded through some version of just about everything available.

From all of this experience I have come to what I consider to be a fundamental understanding about financial markets. They cannot be consistently predicted with sufficient accuracy to be profitable, especially on a short-term basis. Sometimes a system or advisor will have a successful run but the probability is about .999 that it was a random event and the purveyor of the system or the advisor is no doubt convinced that s/he has the market's "number." They are in all probability self-delusional or are trying to con you. My mail each week brings in around a dozen "letters" offering me advisory services with phenomenal track records or software packages that are "guaranteed" to make me rich. This is almost certainly marketing HYPE. If these folks could do what they say, they wouldn't need to aggressively seek clients but rather would be so busy making money they wouldn't care about the money from your subscription or purchase. This kind of material should be sent straight into the trashcan unopened. Unlike postal mail, you can block email solicitations and don't even have to personally trash them. The worst of all are telephone solicitations. I've actually had such individuals become angry because I refused to talk with them and call back repeatedly after I have told them "No thanks" and hung up. I even had one call back and curse out my teenage son who happened to answer the phone. Hang up on these predators!

I've also spent enormous amounts of time creating and testing technical systems. At one point, I even invested a huge amount of time in developing a complex regression model based on both technical and fundamental data that could account for over 95% of the variance in the S&P 500 on a week-to-week basis. None of the approaches tried are reliable enough to be consistently profitable over long periods of time. In short, I have tried just about everything and am not especially impressed with any method.

So, what is one to do? Assuming that one doesn't want to put all one's financial assets in an interest bearing cash account I have several suggestions. First, the best way to avoid losing money in financial markets is to minimize your exposure to them. Second, never put all of your assets at risk at one time. Third, have clear criteria for getting into and out of the market. On this last suggestion, I can offer the two Market Barometers on this site as a partial answer. These barometers have been developed using indicators that historically have been associated with positive market environments. I say associated because the relationships are correlational and not causal. What they provide is an "educated" guess about the market environment. They are not short-term timing systems and often give a signal ahead of or after a turning point. Sometimes they are just flat wrong. However, they along with some basic technical indicators such as weekly moving averages and relative strength indicators allow one to make about the best “educated” guess possible.

In addition to posting the Market Barometer I will post tables and comments that tie in a couple of technical indicators that can possibly add useful information upon which to make a judgment. I will also try to give my overall take on what the data are suggesting. I do think that one should combine an “educated” guess about the market with at least a basic form of money management such as the 50% exposure rule discussed on this site. I also think that it could be useful to have a stop loss criterion that at least cues one to consider giving up on a position. How lenient a stop loss you set should be determined, in part, by one’s personal comfort level. Do look at the Money Management paper and the Planning for Trading paper for more details on some of the points made above. I hope you find the information provided on this site useful and I wish you the best of luck in your sparring with the market.